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Arbitration provisions in attorney-client agreements

Do you know the pros and cons?

Arbitration, the process of submitting a dispute to one or more impartial decision makers or "neutrals" for a final, binding, and confidential award that is generally not appealable, has become common in the legal industry for resolving professional liability claims. There is a strong public policy in certain states encouraging arbitration agreements and many attorneys and law firms include them as a standard provision in their retainer agreements to resolve fee disputes as well as malpractice claims. Arbitration, however, may not be appropriate in every case. The following article discusses certain advantages and disadvantages to arbitration agreements, as well as certain enforceability issues.

Arbitration: weighing the pros and cons

The waiver of the right to appeal is perhaps the most important factor to consider when contemplating arbitration. If an adverse award is entered, there is generally no way to dispute the award, although some agreements allow an appeal to state court if abuse of discretion or fraud is shown. Waiving the right to appeal, therefore, makes it all the more important to select an appropriate and credentialed panel. Generally, parties select from a panel of neutrals familiar with the subject matter. Many county and state bar associations appoint neutrals in the subject matter of the underlying case. Some attorneys provide for the credentials of the arbitrators within the agreement Presumably at least, the more experienced and credentialed the panel, the more likely that the panel will "get it right". Regardless, there is no assurance that the panel will apply the law accurately and the panel may be less knowledgeable about the law than an experienced judge.

Further, there is often a suspicion that an arbitration panel is more likely to "split the difference" rather than making a tough decision. There is also a perception that an arbitration panel is less likely to deliver a "runaway" award, an award on equitable principals or impose punitive damages. Some attorneys find that waiving the right to appeal is not an option and consequently preserve the right to appeal within the agreement. While this may be a seemingly attractive option, one advantage to arbitration is to diminish legal expenses and protracted litigation. If the right to appeal is preserved, however, any cost savings advantage to arbitration may be diminished. If an appeal is taken, legal fees can spiral out of control and it could take years until final resolution of the case. Moreover, many attorneys are attracted to arbitration due to its confidential nature. Preserving the right to appeal will generally also negate the confidentiality provision, if an appeal is taken.

Finally, there is usually no formal discovery in arbitration. This is advantageous in that this too can save on litigation costs, deter fishing expeditions, and end protracted litigation. If the agreement is silent on this issue, however, an arbitration panel may impose significant discovery or even electronic discovery upon the parties. Alternatively, the panel may direct the parties to very limited discovery, which may keep important facts concealed. You may be able to specify the extent to which discovery is allowed in the retainer agreement with full disclosure and consent of the client. Finally, keep in mind that some defense counsel report that it is not necessarily less expensive to arbitrate. A panel of professional arbitrators, each billing at an hourly rate, can easily far exceed a standard defense budget. Depending upon the hourly rate of your panel and the scope of discovery, arbitration fees and costs can approach or exceed the cost of a litigated case.

Enforceability/Ethics

The inclusion of a mandatory arbitration term can create both enforceability and ethical concerns and may raise issues of informed consent with the client. Although some states may limit this practice, more and more states are favoring arbitration as a matter of public policy. To be enforceable, generally, the client must be fully advised of the terms and consequences of an arbitration provision and must knowingly consent to it, preferably in writing. A lack of informed consent by the client may limit its enforceability. The arbitration provision must be clearly written and conspicuous. Some states require independent representation for the client before entering into a retainer agreement that contains an arbitration provision. As you can imagine, hiring independent counsel for routine legal matters may be burdensome for some clients, but without it, the agreement may be held to be unenforceable depending upon the jurisdiction and terms. It is best to research your respective state law and bar association for any local law or polices regarding arbitration.

Insurance coverage

From an insurance perspective, make sure that such provisions do not violate terms or conditions of any insurance policy. Most professional liability policies contain the following or a similar provision:

> No Insured shall, without prior written consent of the Company, incur any expense, make any admission, admit liability, settle or attempt to settle any claims, assume any obligation, or agree to arbitration or any similar means of resolution of any dispute.

Some carriers may take the position that such policy language prohibits the inclusion or triggering of any arbitration provision in a retainer agreement without prior agreement by the insurance company. It is important to determine how your carrier interprets this or similar provisions. Finally, most insurers prefer that their insureds not pursue fee litigation. Keep in mind that the American Bar Association estimates that two–thirds of legal malpractice claims are the result of a counter-claim in response to a fee suit. Spelling out in the retainer agreement how fees and expenses are to be paid and when they are due is key to avoiding disagreements with the client. Maintaining large, unpaid balances also invites contention. Whether you include an arbitration provision in your retainer agreement or not, use caution before you initiate a collection action against a client, whether in an arbitration or a civil suit.